

FDIC State Profile

Summer 2005

Puerto Rico and the U.S. Virgin Islands

Job growth in Puerto Rico and the U.S. Virgin Islands (USVI) has moderated from recent peaks.

- **Puerto Rico's** job growth subsided in first quarter 2005 and trailed the U.S. (See Chart 1). Slower growth reflected job losses in manufacturing and retailing. Manufacturing losses have continued in eight out of the past nine years and have been primarily in computer and electronic products, food processing, and apparel. Job gains in public employment, health and leisure services, however, pushed overall employment into positive territory.

Pharmaceuticals are a positive development for Puerto Rico's manufacturing sector.

- Puerto Rico's pharmaceutical industry has played an important role as the island is becoming a global player in drug manufacturing, health care, and biotechnology. Representing more than one-fifth of its manufacturing workforce and growing, three-quarters of the top U.S. pharmaceutical companies operate manufacturing facilities in Puerto Rico. Pharmaceutical jobs, which tend to offer higher wages than Puerto Rico's apparel and food processing employment, have partially offset the decline in the island's other manufacturing industries.

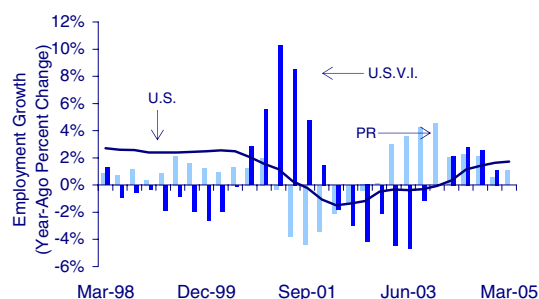
Puerto Rico's public sector is a key economic driver.

- The public sector remains a key component of Puerto Rico's economy. Public spending on housing, schools, and infrastructure continues to be an important source of jobs and income. Government employment accounts for approximately one-third of the total workforce, compared with about 15 percent in the U.S. (See Chart 2).

Tourism remains Puerto Rico's main attraction.

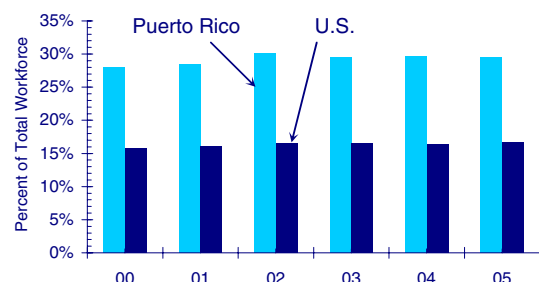
- Tourism continued to rebound in Puerto Rico, with cruise ship visitors and hotels enjoying robust activity in 2004. In the 2004 high tourist season, December 2004 - April 2005, hotel occupancy rates averaged 79 percent, which was higher than **Miami**, a mainland competitor.
- Tourist arrivals to Puerto Rico and the USVI in 2004 approximately doubled 2003 levels and increased more than in the **Dominican Republic** and **Jamaica**, but arrivals were lower than in **Aruba** and **Cancun**. Puerto Rico faces

Chart 1: Job Growth in Puerto Rico and the U.S. Virgin Islands Now Trails the U.S.



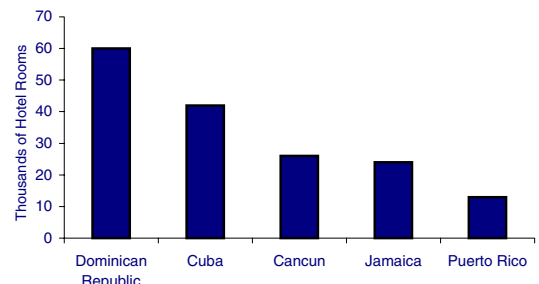
Source: Bureau of Labor Statistics

Chart 2: Puerto Rico's Public Sector Constitutes a Greater Share of the Workforce than the U.S.



Source: Bureau of Labor Statistics

Chart 3: Despite Additions Puerto Rico Has Less Hotel Rooms than Competitors



Source: Roman, Elisabeth "Puerto Rico Continues Falling Behind in Hotel Development", Puerto Rico Herald, March 10, 2005.

stiff tourist competition from other Caribbean destinations, including the Dominican Republic, Jamaica, Cancun, and **Cuba**. All of these competing destinations have a significantly greater number of hotel accommodations than Puerto Rico (See Chart 3).

High home prices strain personal finances.

- The median price for a single-family home in Puerto Rico was \$188,700 in 2004, which approximated the U.S. median of \$191,000. However, with a median household income of \$19,600, about two-fifths of the U.S. average, Puerto Rico's housing costs are significantly higher relative to income than on the mainland, thereby straining home affordability.
- Luxury housing tends to dominate the USVI housing market and is driving up local home prices. On **St. Johns**, the average house sold for \$448,000 in 1999. By 2004, the average house sold for \$1.25 million, an increase of 180 percent.

Residential lending has grown with the rise in home prices, but mortgage quality may be showing signs of weakness.

- Residential mortgages continued to be the primary component of loan portfolios among institutions headquartered in the area. Most Puerto Rico/USVI banks reported increases in residential loans, pushing the ratio of residential loans-to-total loans up to 49 percent from 31 percent only three years ago.
- Home equity loans also have grown but remain a small portion of loan portfolios among Puerto Rico/USVI-based institutions.
- Delinquencies in residential loan portfolios were below levels reported during the early 2000s. However, residential mortgage loan quality may be showing some signs of strain as the median residential loan past-due rate reached 4.01 percent in first quarter 2005. This marked the third consecutively quarterly increase, in contrast to the steady reduction for U.S. mainland institutions.
- Overall credit quality has improved. The median past-due loan ratio, while consistently higher than on the U.S. mainland, has declined (See Chart 4). Early-stage (loans 30-89 days past due) and late-stage delinquency rates (loans at least 90 days past due), as well as charge-off rates, are lower than one year ago.

Puerto Rico and USVI banks reported favorable profitability, but margins may shrink in the face of a flatter yield curve.

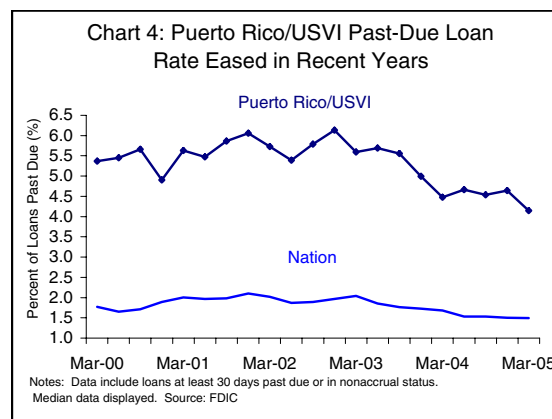
- Return on assets reported by Puerto Rico and USVI institutions increased slightly compared with one year ago. Net interest margins (NIMs) increased slightly and

provisions for loan losses declined amidst favorable credit quality.

- NIMs, which typically rely on the spread between long- and short-term interest rates, may decline following flattening in the yield curve. The yield curve has become considerably less steep since year-end 2004, narrowing to its flattest level in four years.

Higher reliance on non-core funding and increasing short-term interest rates have contributed to higher funding costs.

- Puerto Rico and USVI banks rely more on non-core funding, such as brokered deposits and borrowings, largely the result of a considerable "unbanked" population. Non-core funding represents 59 percent of assets compared with 19 percent nationwide.
- Non-core funds, which typically are more sensitive to changes in interest rates than core deposits, has contributed to a more significant increase in funding costs amidst rising short-term interest rates; the median cost of funds has increased 48 basis points since June 2004 among Puerto Rico and USVI banks, compared with 19 basis points nationwide.



Puerto Rico and the U.S. Virgin Islands at a Glance

ECONOMIC INDICATORS (Change from year ago quarter, unless noted)

Employment Growth Rates	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Total Nonfarm (share of trailing four quarter employment in parentheses)	1.1%	2.0%	3.0%	-2.1%	-0.3%
Manufacturing (11%)	-1.1%	0.8%	-0.9%	-12.7%	-4.6%
Other (non-manufacturing) Goods-Producing (7%)	-0.4%	3.1%	-4.1%	-4.3%	-1.0%
Private Service-Producing (53%)	1.3%	2.7%	5.7%	-2.2%	0.4%
Government (30%)	1.9%	1.1%	1.7%	3.9%	0.9%
Unemployment Rate (% of labor force)	10.6	11.2	11.9	12.4	10.8

BANKING TRENDS

General Information	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Institutions (#)	12	13	13	14	14
Total Assets (in millions)	97,336	82,078	68,379	60,854	51,996
New Institutions (# < 3 years)	0	0	0	0	1
Subchapter S Institutions	1	1	1	1	1

Asset Quality	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Past-Due and Nonaccrual Loans / Total Loans (median %)	4.12	4.40	5.61	5.77	5.58
ALLL/Total Loans (median %)	1.23	1.33	1.44	1.26	1.22
ALLL/Noncurrent Loans (median multiple)	0.52	0.49	0.42	0.43	0.48
Net Loan Losses / Total Loans (median %)	0.65	0.68	0.78	0.83	0.78

Capital / Earnings	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Tier 1 Leverage (median %)	6.86	7.10	6.66	6.39	6.80
Return on Assets (median %)	1.31	1.28	1.24	1.18	1.11
Pretax Return on Assets (median %)	1.68	1.62	1.40	1.34	1.37
Net Interest Margin (median %)	3.49	3.42	3.61	3.64	3.62
Yield on Earning Assets (median %)	6.83	6.75	7.07	7.36	7.85
Cost of Funding Earning Assets (median %)	3.40	3.33	3.53	3.70	4.11
Provisions to Avg. Assets (median %)	0.33	0.41	0.42	0.39	0.39
Noninterest Income to Avg. Assets (median %)	0.64	0.67	0.68	0.70	0.65
Overhead to Avg. Assets (median %)	2.36	2.41	2.45	2.62	2.60

Liquidity / Sensitivity	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Loans to Assets (median %)	53.9	53.4	53.9	54.5	59.5
Noncore Funding to Assets (median %)	59.0	58.5	59.4	61.7	59.9
Long-term Assets to Assets (median %, call filers)	49.3	43.0	33.0	30.2	36.3
Brokered Deposits (number of institutions)	9	10	10	11	11
Brokered Deposits to Assets (median % for those above)	11.2	12.8	15.1	12.0	4.6

Loan Concentrations (median % of Tier 1 Capital)	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Commercial and Industrial	92.8	135.2	150.3	173.5	170.3
Commercial Real Estate	177.8	181.7	227.6	218.4	221.5
Construction & Development	40.8	46.6	58.3	50.5	49.0
Multifamily Residential Real Estate	0.5	0.0	0.4	0.7	0.7
Nonresidential Real Estate	118.0	132.3	122.6	141.9	134.9
Residential Real Estate	249.0	287.2	256.8	210.4	205.1
Consumer	44.4	68.9	92.0	140.2	147.7
Agriculture	3.0	0.1	0.2	0.2	0.2

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
San Juan-Caguas-Guaynabo, PR	11	38,404	< \$250 million	2 (16.7%)
Ponce, PR	11	1,868	\$250 million to \$1 billion	0 (0%)
Aguadilla-Isabela-San Sebastián, PR	7	1,132	\$1 billion to \$10 billion	6 (50%)
Mayaguez, PR	11	1,112	> \$10 billion	4 (33.3%)
San Germán-Cabo Rojo, PR	4	637		